May 4, 2004

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BEFORE THE
U.S. COAST GUARD, DEPARTMENT OF HOMELAND SECURITY
AND
MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION

DOCKET NO. USCG-2003-14472/DOCKET NO. MARAD-2003-15171 - 21

VESSEL DOCUMENTATION: LEASE FINANCING FOR VESSELS ENGAGED IN THE COASTWISE TRADE; SECOND RULEMAKING

COMMENTS
OF
IC LEASING CORPORATION II

STATEMENT OF INTEREST

IC Leasing Corporation II ("IC Leasing II") appreciates the opportunity to submit these comments on the Joint Notice of Proposed Rulemaking (the "Joint Notice") published February 4, 2004 in the Federal Register (Volume 69, Number 23 at pages 5403-5410) on behalf of itself and its parent, Illinois Central Corporation, and its ultimate parent Canadian National Railway Company ("CN"). In the Joint Notice, the Coast Guard proposes to amend its regulations on documentation, under the lease financing provisions, of vessels engaged in the coastwise trade, and MARAD proposes to amend its regulations to require MARAD's approval of, inter alia, all time charters respecting the use of a lease-financed vessel engaged in the coastwise trade back to the vessel's owner, the parent of the owner, a subsidiary or affiliate of the parent, or an officer, director, or shareholder of one of them.

CN, directly and through its subsidiaries, is engaged in the rail transportation business. CN is the fifth largest freight rail carrier in North America, with 2003 revenues of nearly U.S. $4.2 billion. The group's U.S. rail

operations include: the Duluth, Winnipeg and Pacific Railway Company, which operates in Minnesota and Wisconsin; the Grand Trunk Western Railroad, which operates in Michigan, Illinois, Indiana, and Ohio and from the international border at Port Huron/Sarnia and Detroit/Windsor to Chicago; the St. Clair Tunnel Company, which operates in Michigan; the Wisconsin Central Ltd., which operates in the Upper Mid-West; and the Illinois Central Railroad and other smaller railroads. The group's network extends from the Upper Mid-West to the Gulf of Mexico. In 1998, the group entered into a marketing alliance with The Kansas City Southern Railway Company, thus becoming part of a NAFTA rail network offering shippers access to Mexico's largest rail system.

CN is publicly traded and more than 50% of its shares are owned in the United States. Roughly 6,000 of the group's route-miles are in the United States located in 15 states.[1] More than 6,000 employees work in the United States, the vast majority of whom are union members.

On April 9, 2004, the Surface Transportation Board ("STB") approved CN's proposed acquisition of three rail carriers owned by Great Lakes Transportation LLC (GLT): Duluth, Missabe and Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company.

As part of the transaction to acquire GLT's transportation carriers, but separate from the STB portion of the acquisition, Illinois Central Corporation, through its subsidiary IC Leasing Corporation II, is the prospective purchaser of a portion of GLF Holdings Corp., which through its subsidiaries Great Lakes Fleet, Inc. and GLF Great Lakes Corp. (the "Vessel Owners") is the owner and operator of eight United States flag vessels (the "Vessels") engaged on the Great Lakes in the U.S. coastwise trade. The eight Great Lakes vessels will comprise a vital part of an intermodal rail and vessel transportation network servicing the Great Lakes region. This transaction will enable U.S. customers, particularly the U.S. steel industry, to benefit from new efficiencies, improved service and increased shipper options, without any compromise of U.S. cabotage or vessel finance laws and existing rules.

SUMMARY

IC Leasing II opposes the adoption of the Joint Notice's proposed changes to:

1. Section 67.20(a)(6) ("Alternative 1") and Section 67.20(a)(9) ("Alternative 2") dealing with "chartering back";

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[1] Alabama, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Nebraska, New York, Ohio, Tennessee, Vermont, and Wisconsin. After the completion of the transaction, Pennsylvania will become the 16th state.

2. Section 67.20(b)-(e) dealing with grandfathering;

3. Third party audits; and

4. MARAD approvals of time and other non-demise charters under Section 221.13(c).

CHARTERING BACK

IC Leasing II agrees fully with the Joint Notice's view that it is the actual text of a charter or other contract that governs its characterization and not the title given to it. We also agree that a side agreement that changes the nature of the legal relationship among owner, demise charterer and/or sub-time charterer should be considered openly as part of the private parties' agreements that form the basis of a vessel documentation under 46 U.S.C. §12106(e) (the "Lease Finance Law"). Consequently, all of our comments below go to the legal relationships created not by titles but by complete documents.

Alternative 1– IC Leasing II does not object in principle to Alternative 1's proposed change to 67.20(a)(6) to include within the limitation the overall group of which the owner is a member. However, IC Leasing II urges that the rule clearly state that all sub-charters to a member of the owner's group other than a sub-demise charter, as such terms are defined by existing United States case law, are presumptively lawful charters-back. Consequently, IC Leasing II urges that sub-time charters, sub-voyage charters, sub-space charters, sub-contracts of affreightment and all other non-demise types of contracts dealing with the hiring of a vessel or a portion thereof to a member of the owner's group presumptively constitute lawful charters-back. For convenience, we refer to all time charters and the other non-demise contracts described in the preceding sentence generically as "time charters"; the analysis for all such non-demise charter types is the same and the main point is the distinction between time charters and such other charters on the one hand and demise charters on the other hand.

It is appropriate and certainly within the statutory mandate of the Lease Finance Law for Coast Guard to make a determination that the contractual relationship between the lessor and its immediate charterer constitutes a "demise" charter. Establishing that relationship goes to the heart of the statute's requirement that operational control be transferred to the U.S. citizen demise charterer. That same logic applies to a sub-demise charter – the determination being whether the head demise charterer transferred its status as "owner *pro hac vice*" to a sub-charterer. However, because types of charters such as a time charter by definition do not transfer such status or "control," the Lease Finance Law does

not provide for any further inquiry by any regulatory authority once it is determined that a proposed sub-charter is not on a demise basis.

An analysis of whether a charter transfers control and possession of a vessel, and is therefore properly characterized as a demise charter rather than a time charter, should always begin with "the general presumption that the owner [of the vessels] does not mean to put his vessels into the possession of the charterer." *Hansen v. E. I. DuPont de Nemours & Co.*, 33 F.2d 94, 96 (2d Cir.), *cert. denied*, 280 U.S. 589 (1929). *See also Matute v. Lloyd Bermuda Lines, Ltd.*, 931 F.2d 231, 235 (3d Cir. 1991) ("Courts are hesitant to imply a relinquishment of possession and control by the owner of a ship absent the most explicit language"). An often-cited test was set out by the U.S. Supreme Court in *Guzman v. Pichirilo*, 369 U.S. 698, 699-700 (1962):

> To create a demise the owner of the vessel must completely and exclusively relinquish "possession, command, and navigation" thereof to the demisee. . . . It is therefore tantamount to, though just short of, an outright transfer of ownership. However, anything short of such a complete transfer is a time or voyage charter party or not a charter party at all. [Emphasis added]

Although the vessel owner retains legal title, the demise charterer's obligations to third parties are essentially those of an owner.

The transfer of control and possession from the owner to the demise charterer typically involves hiring and giving orders to the master and crew and being responsible for operating expenses, maintenance, repair and insurance. *Walker v. Braus*, 995 F.2d 77, 81 (5th Cir. 1993) (noting that under a demise charter, the vessel is transferred "bareboat," and the demise charterer must supply "crew, provisions, fuel . . . supplies" and "essential operating expenses").

Control of the vessel is one of the lynchpins upon which U.S. courts have based their decisions as to whether a charter is a demise or a more limited form of hiring arrangement, such as a time or voyage charter. At the most fundamental level, it is the master of the vessel who has the final word with respect to operational control of the vessel because the master makes all significant navigation and operational decisions. *Stevens v. Seacoast Co., Inc.*, 414 F.2d 1032, 1035-36 (5th Cir. 1969). For this reason, the identity of the employer (which term as used herein encompasses a ship manager or crewing agent) of the master has been widely used by courts as a bright-line test to distinguish which entity is the "owner" of the vessel. *See, e.g., Guzman*, 369 U.S. at 700 (holding that there was no demise where the master was employed by the vessel owner even though the charterer paid for "'the seamen, food, repair, maintenance, drydocking; which in a regular charter party are excluded'"). Courts have held that a demise is "extremely unlikely" when

the owner supplies the master and crew. *Fitzgerald*, 451 F.2d at 676. In the rare circumstance where a master in the owner's employ is "subject to the orders of the demisee during the period of the demise," a demise has been found, once again highlighting the vital role the master plays in the operation and control of the vessel. *Guzman*, 369 U.S. at 701. *See also* Sheldon A. Gebb, "Admiralty Law Institute: Symposium on Charter Parties: The Demise Charter: A Conceptual and Practical Analysis," 49 TULANE L. REV. 764, 768 (1975). However, no court has held that a "time charterer" in fact can be the employer of master and crew without the "time charter" being recharacterized as a disguised demise charter.

In contrast, a time charter is a contract pursuant to which the charterer merely hires by contract the cargo carrying capacity of the vessel for a specified time (a "time charter") or for a particular journey or series of journeys (a "voyage charter" or "consecutive voyage charter"). A time charterer is not the employer of the master or crew, nor is it responsible for "ship navigation and management or the long-term financial commitments of vessel ownership." *Kerr-McGee Corp. v. Ma-Ju Marine Services, Inc.*, 830 F.2d 1332, 1340 (5th Cir. 1987) (citing G. Gilmore & C. Black, *The Law of Admiralty* § 4-1 (1975)). The character of a time charter was described by the United States Supreme Court in 1870 in *Reed v. United States*, 78 U.S. 591, 600-01 (1870), a case which continues to be cited affirmatively today:

> [W]here the general owner retains the possession, command, and navigation of the ship and contracts for a specified voyage, as, for example, to carry a cargo from one port to another, the arrangement in contemplation of law is a mere affreightment sounding in contract and not a demise of the vessel, and the charterer or freighter is not clothed with the character or legal responsibility of ownership.

The time charterer only has "control" in the sense that it is able to instruct the demise charterer as to what cargo the vessel is to carry and the ports of loading and unloading of that cargo. See also, *Fitzgerald v. A. L. Burbank & Co., Ltd.*, 451 F.2d 670, 676 (2d. Cir., 1971), where the court emphasizes that "the mere fact that the charterer has some control over the master, or that the charterer selects the routes to be taken or the cargo to be carried does not make him the owner *pro hac vice*." Furthermore, even these limited instructions are subject to override by the master of the vessel, who may, for example, refuse to load or to discharge at a certain port or berth, or refuse to carry the nominated quantity or type of cargo based on his experience, physical limitations, directions of the flag sovereign or standing instructions.

Significantly, except as otherwise explicitly mandated by statute[2], the demise charterer alone bears the liability to third parties and crew members for any injuries caused as the result of negligence in the maintenance or operation of the vessel. *See, e.g.*, *Walker*, 995 F.2d at 81 (demise charterer "has liability for any and all casualties" resulting from the operation of the vessel); *Matute*, 931 F.2d at 235 (demise charterer is "subject to an owner's liabilities such as 'maintenance and cure' of the crew"). Consequently, absent a specific statute to the contrary such as OPA 90, when an owner has demised his vessel to a demise charterer, during the demise period, the owner no longer has personal liability for vessel or crew maintenance or negligent operation. All that is taken on by the demise charterer in its owner "*pro hac vice*" or temporary owner role.

Based on such a clear and well-established distinction between demise and time charters, the regulatory concern should be to determine only that (A) the owner has met the statutory requirement of the Lease Finance Law of entering into a demise charter of not less than three years duration to a coastwise citizen, and (B) the demise charterer has not entered into a sub-demise charter, as the latter would transfer operational control from the demise charterer to the sub-demise charterer. Once these requirements are satisfied, there is no valid statutory basis or legal precedent, and consequently no valid reason, for further inquiry into the relationships among the parties. The presumption should be that a non-demise charter-back arrangement is legitimate.

Alternative 2 – IC Leasing II objects to Alternative 2's proposed change to 67.20(a)(9). Alternative 2 is a conclusive presumption that a demise charterer is not the owner *pro hac vice* when there is a "sub-charter" to a member of the owner's group, unless the vessel exclusively carries proprietary cargo. The requirement that a demise charterer be the owner *pro hac vice* in order for the vessel to qualify for documentation under the Lease Finance Law itself is found in 67.20(a)(9) as promulgated in the Final Rule. The statutory text of the Lease Finance Law refers only to a "demise charter" and "demise charterer"; the phrase "owner *pro hac vice*" is not used.

A demise charterer is an "owner *pro hac vice*" – the terms are synonymous and used interchangeably. *See, e.g.*, *Black's Law Dictionary* (7th ed. 1999). There are no definitional criteria that differentiate "demise charterer" and an owner "*pro hac vice*." As discussed below, we believe comments made by Coast Guard in paragraph 14 of the Final Rule purporting to distinguish between a demise charterer and "owner *pro hac vice*" have no basis in statute or case law. Consequently, if Coast Guard believes there are specific elements that identify

[2] The Oil Pollution Act of 1990, 33 U.S.C. §2701 et seq. (2004) ("OPA 90"), is an example of a statute pursuant to which an owner retains operating liability even after the owner has demised the vessel to a demise charterer.

when a demise charterer is an owner "*pro hac vice*" and when it is not, they should be spelled out specifically in the regulations.

A long history of United States federal case law exists that defines the concepts of a "demise charterer" and its synonym, an owner "*pro hac vice*", and "time charterer." Regulations should not adopt meanings of the relationships embodied in these terms that are different from well-established U.S. case law unless Congress itself through statutory change explicitly requires it. Doing otherwise promotes confusion. The Lease Finance Law makes no attempt to define or redefine "demise charterer" or "owner *pro hac vice*." There is no basis for regulations to do so.

U.S. case law uniformly construes demise charterer and owner *pro hac vice* as synonymous concepts. All owners *pro hac vice* are by definition demise charterers; all demise charterers are by definition owners *pro hac vice*. *See, e.g., Fitzgerald*, 451 F.2d at 676 ("[T]he law of admiralty has long recognized that in some situations a charterer of a vessel will be treated as the owner and called the owner *pro hac vice*. A charter giving rise to such an effect is generally known as a demise or bareboat charter."); *Aird v. Weyerhaeuser S.S. Co.*, 169 F.2d 606, 609-10 (3d Cir. 1948) ("If the owner of the vessel has given entire possession and control of it to another by virtue of a demise charter . . . , the person thus put in possession and control of the vessel becomes special owner for the voyage . . . [and] is frequently described as 'owner *pro hac vice*.'"). Both terms describe the situation that exists when a vessel owner gives over exclusive operational control and possession of the entire vessel to the demise charterer, who in turn is considered the owner *pro hac vice*. "*Pro hac vice*" literally means that the demise charterer is standing in the place of the owner "for this time" (the term of the charter) and "consequently [the demise charterer] becomes subject to the duties and responsibilities of ownership." *Leary v. United States*, 81 U.S. 607, 610 (1871); *Vitozi v. Balboa Shipping Co., Inc.*, 163 F.2d 286, 289 (1st Cir. 1947).

Alternative 2 broadly uses the term "sub-charter" without definition. "Sub-charter" apparently would include sub-demise charters, sub-time charters, sub-voyage charters, space charters, contracts of affreightment, and any other contractual relationship whereby the demise charterer agrees to carry cargo or provide service to or for a third party. We agree that there should be regulatory oversight of a sub-demise charter, precisely because a sub-demise charter constitutes a complete handing over of the vessel to the sub-demise charterer. The latter would consequently become the owner *pro hac vice*.

However, no similar handing over of control to the sub-charterer occurs if the sub-charter is a sub-time charter. Therefore, there is no reason that such a sub-charter should cause any particular scrutiny either of itself or of the relationship between the owner and the demise charterer created by the head demise charter. A "charter-back" in the form of a sub-time charter does not and cannot change the

relationship created by a demise charter between the owner and the demise charterer and therefore cannot have the effect of altering the demise charterer's status as owner *pro hac vice*. No example of how such a purported change in the characterization of the demise charterer as owner *pro hac vice* is suggested by the Joint Notice. No example could be cited because U.S. statutes and case law do not support such a proposition.

Under a time charter-back, the vessels will remain under the control of the U.S.-citizen demise charterer at all times, operating under the U.S. flag with U.S.-citizen crews. Operational control of the vessels never changes to the time charterer's hands; operational control does not somehow "revert back" to the owner due to a sub-time charter to a member of the owner's group. The Joint Notice asserts that if the vessel owner and the time charterer are affiliated, an impermissible level of "control" could (Alternative 1) or would (Alternative 2) be in the hands of a non-coastwise citizen. This is faulty logic. Pursuant to the Lease Finance Law, all lessors are required to be documentation citizens, and all lessors are forbidden from exercising "operational control" over the vessel pursuant to 46 C.F.R. § 67.20(a)(6)). Lessors are owners by virtue of holding legal title due to being the source of financing for U.S.-built vessels, and by appropriate regulation lessors lack the ability and intent to directly or indirectly control the vessel's operations. The operational control rests solely in the hands of the U.S. demise charterer, which employs a U.S. master and U.S. crew and remains (except for OPA 90 purposes) solely liable for contractual and tort obligations. The time charterer, whether an affiliate of the vessel owner or not, merely rents space and time on a vessel and does not assume the benefits and risks associated with ownership.

Most significantly, pursuant to the stated policy underlying Section 9 of the Shipping Act, 1916, as amended (46 U.S.C. app. §808) ("Section 9"), U.S. demise charterers are always under the statutory obligation to relinquish to the authority of the United States control of their vessels and crews in times of national emergency, no matter whose cargo they may be carrying at the time.

It follows therefore that it does not matter whether the sub-time charterer is related to the owner's group. Because additional control cannot be imputed to the owner (or sub-time charterer) and the demise charterer does not lose any control, in each case as a result of the existence of a sub-time charter, examining the latter is pointless. And Alternative 2's categorically recharacterizing the demise charterer as not really the owner *pro hac vice* is without statutory or case law basis. In fact, the additional burden of having only Lease Finance Law sub-time charters (and not other time charters) approved by MARAD will have a chilling effect on non-coastwise citizen investors because it is a very narrow, discriminatory selection of vessels that would be affected.

A sub-time charter by an affiliate of the owner does not somehow transfer control back to the owner or endow the time charterer with such control. U.S. demise charterers and their citizen crews are still benefiting financially from such a transaction and are still subject to the same obligations. Lessors are inevitably making an investment in U.S.-built vessels with U.S. demise charterers in order to further their own economic interests. When fewer non-coastwise citizen investors see the benefits of such investment, it will certainly defeat the purpose of the Lease Finance Law, which was intended to provide increased sources of capital for the coastwise trade.

If regulations are deemed necessary, they should be confined only to defining what constitutes an impermissible sub-demise charter. As suggested above, based on federal case law, the elements of a sub-demise charter should include all of the following: the ability to hire and fire the master and crew and the responsibility for physical operation of the vessel, including issuing orders to the vessel, supplying necessaries, insurances and repair and maintenance.

In lieu of proposed limitations on chartering back, it is respectfully suggested that the current requirement for a vessel to include in its advance notice of arrival (ANOA) information concerning the charterer of the vessel provides the government with sufficient information to determine whether there is an abuse of the law. The requirement to include the name of the charterer was first established in the final rule issued on August 19, 2002 (67 Fed. Reg. 53735-40). The requirement was retained in the latest modification of the ANOA regulation on February 28, 2003 (68 Fed. Reg. 9537-47). As noted at 33 CFR §160.204 charterer means:

> [T]he person or organization that contracts for the majority of the carrying capacity of a ship for transportation of cargo to a stated port for a specified period. This includes "time charterer" and "voyage charterers."

GRANDFATHER PROVISIONS

IC Leasing II urges that the grandfather provision not be limited to a three year period and that the grandfathering include all transactions that were approved in writing prior to February 4, 2004 for the remaining useful life of the relevant vessels. IC Leasing II's planned transaction was explicitly designed to meet not only all maritime statutory requirements but all regulatory requirements in effect, including the Final Rule.

If grandfathering provisions are adopted, all transactions that have received specific written approvals prior to February 4, 2004 should be grandfathered.

A three year grandfather period is far too short in terms of economic planning. Leases are very often for a period equal to the maximum period permitted under the relevant tax laws while maintaining the lease as a "true lease" for tax purposes. A common measure is 80 percent of the remaining useful life of the vessel measured at the time the lease is entered into.

In addition, a three-year grandfather provision is so short that it effectively prevents mid to long-term business planning and therefore will have the consequence of discouraging investment, contrary to the stated intention of the Lease Finance Law. Financing of vessels, whether through loans or leases cannot be done economically on such a short term basis. An investor/lender who becomes a lessor normally calculates that its initial investment plus an economic return (into which are factored such risk elements as OPA 90 liability) be recovered through charter hire paid during the course of the lease term together with the residual value of the vessel. In order to meet this calculation over a three-year lease term, the lease rentals would have to be so high as to make the lease financing structure economically unfeasible to the lessee or the lessor would have to accept a far greater, and economically prohibitive, risk on the residual value of the vessel after the end of the lease term than lessors are normally willing to accept. Consequently, neither lessee nor lessor is likely to enter into such a transaction, if the proposed rule in the Joint Notice is adopted.

The minimum grandfathering provision should be a period that is not less than the remaining useful life of the vessel.

THIRD PARTY AUDIT

Section 3 of the Joint Notice of February 4, 2004, states that Coast Guard is considering whether an independent auditor "with expertise in the business of vessel financing and operations" should be required to certify that any particular transaction involving a Lease Finance Law documentation accords with both statutory and regulatory requirements. This is a bad idea. Any such auditor would necessarily create additional cost to the parties to the transaction (auditor's fees; costs of application, etc.) as well as delay for the auditing process itself. In addition, a third party, that is, non-governmental auditor, could readily have the appearance of bias in any particular transaction. Lease financing already has substantial burdens imposed by statute and regulations. Already built into the cost of a lease financing are the costs of a U.S. coastwise citizen operator and, from the point of view of the lessor, potential, unlimited OPA 90 liability. In addition to the regulatory requirements built into the Final Rule, including citizenship certifications from the lessor and the demise charterer, there is the new administrative requirement of establishing that there is an element or component of financing, which we understand that, after February 4, 2004, the Coast Guard is

requiring all owner lessors to provide. Lease financing documentation under the Lease Finance Law is already burdensome and a significant economic disincentive. Adding a special auditor is a further unnecessary layer of expense and delay, especially because the proposed auditing process is unlikely to produce greater benefits than the self-certifications that have worked for decades to document a vessel.

If such an auditor does become required by regulation, a U.S. regulatory authority should be charged with the audit process. In addition, the elements such an auditor would have to find and the criteria for finding them should be set forth in new proposed regulations. These elements would include the following:

1. Whether the lessor meets the statutory requirement of being "primarily engaged in leasing or other financing transactions" as further defined by regulations;

2. Whether the contract between the lessor and the demise charterer respecting the Vessel actually constitutes a demise charter;

3. Whether and for what reasons the demise charterer loses its identity as an owner *pro hac vice*.

4. If the proposed rule set forth in the Joint Notice relating to §67.20(a)(6) and/or (a)(9) is adopted, is there a "sub-charter" to a member of the group of which the vessel owner is a member;

5. If such a "sub-charter" exists, does it constitute a sub-demise charter (prohibited) or a sub-time charter (presumptively permitted) or other type of hiring (presumptively permitted); and

6. Whether a new audit is required for each extension of an existing time charter and each new time charter, as well as each sub-voyage charter and each sub-contract of affreightment.[3]

If the requirement for an independent auditor is adopted, that auditor should be a governmental entity that is provided with an appropriate level of expertise and funding. We cannot over-emphasize how vital quick turn-around of decisions would be to the participants of a particular transaction. Uncertainty perhaps even more than delay discourages businesses and makes the long-term planning necessary for the capital-intensive financing of vessels impossible.

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[3] Note that if a proprietary cargo exception is adopted and made exclusive, would an auditor have to certify the proprietary nature of each voyage and each cargo? An independent auditor will have to be paid and a paid auditor will always recommend that he be given additional work.

IC Leasing II opposes the adoption of an auditor requirement, even if a U.S. regulatory authority is designated the auditor. It should be assumed that a regulatory authority would impose an auditing fee, that fee would be a further burdensome cost to the transaction and the audit process would create delay. In addition, any regulatory authority would have to be funded so that it could perform such audits in a timely manner.

In vessel documentation, both Coast Guard and MARAD have long accepted self-certification by the owner that it meets the statutory citizenship requirements. This is true in both public and private company situations. It does not make sense that self-certification be accepted for coastwise documentation generally but to maintain self-certification together with separate evidence of an "element of leasing" is insufficient in one small subset of documentations involving the Lease Finance Law.

MARAD TIME CHARTER APPROVALS

Section 9 of the Shipping Act of 1916 ("Section 9") was originally and primarily enacted for the purpose of "encouraging, developing, and creating a naval auxiliary and naval reserve and a merchant marine to meet the requirements of the commerce of the United States." Preamble, Act of September 7, 1916, 64 Pub. L. 260, 64th Cong., 1st sess., 39 Stat. 728 (codified at 46 U.S.C. App. § 808). As provided in the original Section 9, except when the U.S. was at war or during a national emergency, vessels registered under U.S. law could be sold, leased or chartered to a non-citizen without the approval of the U.S. Shipping Board (the predecessor of MARAD). 64 Pub. L. 260, Sec. 9, 39 Stat. 730-31; *see also Meacham Corp. v. United States*, 207 F.2d 535, 542 (4th Cir. 1953). If a state of war or national emergency existed, the Board retained the ability to approve such a transfer, although the vessel could not be sold until first "tendered to the board at the price in good faith offered by others." 64 Pub. L. 260, Sec. 9, 39 Stat. 731.

Section 9 was amended in 1920 to provide that all vessel transfers to non-citizens required prior approval from the Shipping Board. Congress made clear in the Preamble to the relevant 1920 legislation that the Shipping Board should "keep always in view" that the "primary end to be attained" by Section 9 was to enable the United States to "have a merchant marine of the best equipped and most suitable types of vessels sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency." Preamble, Act of June 5, 1920, 66 Pub. L. 261, 66th Cong., 2d sess., Sec. 250, 41 Stat 988. This approval requirement remained in effect until the 1992 promulgation by MARAD of a general approval of charters other than demise charters under 46 C.F.R. § 221.13 (the "General Approval").

The fundamental purpose of Section 9, therefore, is to ensure that the United States has available to it, for purposes of both commerce and national security, a sufficient number of "the best equipped and most suitable types of vessels." That purpose was deemed to be served by the General Approval when it was promulgated in 1992, when MARAD determined it "was not inconsistent with the legislative history or with MARAD's national security responsibilities under section 9." 57 Fed. Reg. 23470 (June 3, 1992). Of course, MARAD retains the right to make further investigation in any factual circumstance, that is, to withdraw its General Approval for that particular charter.

Furthermore, the General Approval has been successfully applied for over ten years. Commentators were nearly unanimous in their agreement with the General Approval when it was first proposed, and there has been no change in the underlying law or circumstances that would require a departure from long-standing and effective precedent. There has been no demonstration of a real need for the proposed rule, and no tangible new benefit to be derived.

The only changed circumstance – and the only apparent rationale for re-examining the General Approval – is increased national security concerns in all transportation spheres following the tragic events of September 11, 2001. The Committee on Armed Services of the House of Representatives, in its report accompanying the Bob Stump National Defense Authorization Act, H.R. 4546, 107th Cong., 2d sess., at 420 (May 3, 2002), suggested that MARAD review its general approval policy "to determine whether changes should be made in light of recent concerns over the security in our nation's ports." It is worth noting that this one-sentence suggestion was not adopted by the Senate, nor was it included in the conference report accompanying the defense authorization as enacted. *See* Constantine G. Papavizas and Lawrence I. Kiern, "2001-2002 U.S. Maritime Legislative Developments," 34 J. MAR. L. & COM. 451, 463-64 (2003).

The only legitimate purpose of the new regulation would be to measure if a time charter to an affiliate of the Lease Finance Law owner has shifted an unacceptable level of control away from the demise charterer such that it poses a threat to national security. But as currently proposed, no guidelines for such measurement are suggested. The types of information reviewed by MARAD prior to 1992 (chiefly a copy of the proposed time charter and the names of the parties) would not have provided (and will not provide) a sufficient basis for MARAD to make any determination of a potential security threat. In order for any weighing of a terrorism or security threat to be made intelligently, far more information would be required to be submitted respecting a time charterer than was submitted prior to 1992. Requiring such detailed information (and giving MARAD the time to analyze it) absent a specific link to a security determination would create a significant hurdle for the everyday commerce of shipping. We submit that the reinstatement of

a case-by-case review of time charters by MARAD could not and would not be an effective security measure.

MARAD instituted the General Approval in response to the enactment of Public Law 100-710, 102 Stat. 4735 (1989) (codified at 46 U.S.C. App. § 808). The House Report accompanying the bill that became Public Law 100-710, H. Rep. No. 100-918, 1988 U.S.C.C.A.N. 6104, 6113 (Sept. 15, 1988), notes that the purpose of the law was to "make mortgage and lien laws easier for [MARAD] to administer, to make it less cumbersome for the maritime community to use, and to make it more understandable for everyone involved," *id.* at 6104, and to "promote the documentation of vessels under the U.S. flag" by expanding the eligibility of persons who could be mortgagees of U.S. vessels, *id.* at 6112. Encouraging foreign financing of U.S. vessels was at the core of the 1989 statutory changes and that purpose was effectively carried out.

The sole negative concern of Congress in widening the mortgagee eligibility requirements was that, "[f]or national defense reasons, especially concerning control over the vessels in a war or national emergency," entities with "significant foreign stock ownership" would need to be scrutinized more carefully by MARAD. *Id.* at 6113. The Report advises that MARAD, in granting approvals to mortgagees and other vessel transfers, should restrict "the type of control over the vessel that may preclude its use in a national emergency." *Id.* However, even with this increased scrutiny, the Report notes that MARAD "should not reject a person as a mortgagee just because their stock ownership is significantly foreign" but rather should consider such ownership as a "factor" in determining whether the U.S. government would be impeded from "obtain[ing] physical control of the vessel during a national emergency." *Id.* The same analysis should be applied to the Lease Finance Law.

Based on this legislative history, it is clear that the primary purpose of Section 9 is that U.S. flag vessels engaged in commercial trade be available for use by the U.S. government in a time of national emergency or war. 57 Fed. Reg. 23470 (June 3, 1992). No negative impact on such purpose by the General Approval has been raised. Because sub-time chartered U.S. flag vessels remain under the operational control of the U.S. citizen demise charterer, there is no adverse impact on the vessels' availability to the U.S. government. 67 Fed. Reg. 50406, 50407 (Aug. 2, 2002).

In any event, Section 9 is an ineffective mechanism for protecting the United States from a terrorist attack. Foreign flag vessels calling at U.S. ports far outnumber U.S. flag vessels, and legitimately should be considered a greater potential security risk than a U.S. flagged and crewed vessel that happens to be under time charter to a non-coastwise citizen. The number of U.S. flag vessels time-chartered to affiliates of foreign owners represents only a small percentage of U.S. flag vessels. According to the Joint Notice, only 87 entities have applied to

document a vessel under the Lease Finance Law and only 30 of those have engaged in a charter-back arrangement to an affiliate. 69 Fed. Reg. 5403, 5407 (Feb. 4, 2004). There are a number of protections already in place to protect the national security of U.S. ports (such as recent amendments to the Coast Guard's Advance Notification of Arrival rule and the Maritime Transportation Security Act), with more under consideration by the U.S. Congress and the Department of Homeland Security. The existing rule already prohibits time charters to countries under trade restrictions or at war with the United States. 46 C.F.R. § 221.13(a)(2); 57 Fed. Reg. 23470 (June 3, 1992). Furthermore, under the existing rule, if a national emergency were to occur, or if there were a direct national security nexus between the vessel subject to the charter and the U.S. government, MARAD could revert to case-by-case approval of such time charters. 46 U.S.C. App. § 835.

The proposed rule does not anticipate a return to a review of all time charters, or even to a review of all time charters to non-citizens, but merely the review of a narrow category of time charters involving Lease Finance Law owners and their time-chartering affiliates. 69 Fed. Reg. 5403, 5404-05 (Feb. 4, 2004). Such review would put vessels financed under the Lease Finance Law with chartering-back under a severe commercial disadvantage. In fact, time chartering the vessel to a known entity, such as an affiliate of the vessel owner, might be the best way to ensure the safety of the vessel and avoid a potential risk to U.S. national security.

The proposed rule does not offer any criteria by which to make the determination that a time charter is being entered into for anything other than the generally accepted (and admittedly permissible) purpose of getting cargo hauled and making a profit for the demise charterer. There is seemingly no way for MARAD, by virtue of a review of a time charter entered into by an affiliate of a foreign vessel owner, to distinguish between a "normal business transaction" and a cause of "real concern."

Influential commentators, such as members of Congress and former MARAD administrators, have pointed out that "restrictions on control should be eliminated until MARAD has determined what real and serious threats are posed to our national defense" and "[a]bsent proof that specific facts support a finding of control by non-citizens, the rights of the United States . . . are not impaired."

Significantly, MARAD continues to retain oversight authority concerning all time charters in the event red flags are raised at any stage in the course of the time charter or when a state of national emergency exists. In addition, there are already mechanisms in place to deal with a situation in which an affiliate of a foreign owner effectively gains control of operations of the U.S. flag vessel.

PROSPECTIVE EFFECT ONLY

If any of the proposed rules are made final, their effective date should not be the date of publication of the Joint Notice (February 4, 2004), but rather the date (if any) of publication by final rule. Matters dealt with under the Joint Notice could have an impact on ongoing transactions and the harm to such transactions could be irreparable. Uncertainty as to what will be a permissible structure will encourage financiers not to consider maritime financing.

IC Leasing II objects to any retroactive (or immediate) effect of the proposed rule. Retroactivity is generally not favored under the law. U.S. case law says generally that retroactive application can be made only in extreme circumstances and must be specifically authorized by the applicable statute. In addition to established case law, the Administrative Procedures Act (5 U.S.C. §551, *et seq.*) (the "APA") specifically contemplates that rules will have "future effect." *Id.* at §551(4).

In *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988), the Supreme Court unanimously held that an administrative agency's power to promulgate regulations is limited to the authority delegated by Congress. As a general matter, statutory grants of rulemaking authority will not be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by express terms. *Id.* at 208-09. In *Bowen*, the Secretary of Health and Human Services promulgated regulations in 1981 that set limits on the amounts of reimbursements calculated under the Medicare wage-index. This 1981 rule was invalidated by the courts because the Secretary of Health and Human Services failed to provide notice and an opportunity for public comments. In February 1984, the Secretary of Health and Human Services published a notice seeking comments to re-issue the pre-1981 wage-index method, retroactive to July 1, 1981. *Id.* at 207. A group of respondent hospitals sought judicial relief through the United States District Court for the District of Columbia and the United States Court of Appeals for the District of Columbia Circuit after they had exhausted administrative remedies. Both courts struck down the retroactive application of the rule. *Id.* at 207-208.

The *Bowen* court applied the general rule that retroactivity is not favored in the law. The court stated that, as a general matter, a Congressional grant of rule making authority will not be understood to encompass the authority to enact retroactive rules unless such power is conveyed in express terms. *Id.* at 208 citing, *Greene v. United States,* 376 U.S. 149, 160 (1964): *Claridge Apartments Co. v. Commissioner,* 323 U.S. 141, 164 (1944*); Miller v. United States,* 294 U.S. 435, 439 (1935); *United States v. Magnolia Petroleum Co.,* 276 U.S. 160, 162-163 (1928); *Brimstone R. Co. v. United States,* 276 U.S. 104, 122 (1928) ("The power to require readjustments for the past is drastic. It . . . ought not to be extended so as to permit unreasonably harsh action without very plain words"). The Bowen court further stated that "even where some substantial justification for retroactive rulemaking is

presented, courts should be reluctant to find such authority *absent an express statutory grant.*" *Id.* at 208-209 (emphasis added). The Medicare statute at issue in *Bowen* authorized "retroactive corrective adjustments" which the court emphasized was to be distinguished from a grant of retroactive rule making authority. The *Bowen* court also looked to the legislative history of the underlying statute and found that Congress expressed a desire to forbid retroactive rules *Id.* at 214.

In his concurrence, Justice Scalia discussed the applicable provisions of Sections 551(4) and 551(5) of the APA which define a "rule" and "rule making" as follows: (4) rule "the whole or a part of an agency statement of general or particular applicability and *future effect* designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency *and includes the approval or prescription for the future* of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing; (5) 'rule making' means agency process for formulating, amending, or repealing a rule;" *Id.* (emphasis added). Applying a strict statutory analysis, Justice Scalia concludes that "a rule is a statement that has legal consequences only for the future." *Bowen* at 217.

The arguments against retroactive rule making set forth in the *Bowen* case have been relied on by many courts in a wide variety of factual circumstances. *See, e.g., INS v. St. Cyr.,* 533 U.S. 289, 316 (2001), *Republic Nat'l Bank v. United States*, 506 U.S. 80, 100 (1992), *Pine Tree Medical Assocs. V. Secretary of HHS*, 127 F.3d 118, 121 (1997) (citing *Bowen* statement that rules will not be given retroactive effect unless the language of the law requires such result); *Eastern Enters. v. Apfel*, 524 U.S. 498. 532 (1998) (citing *Bowen* in support of principle that retroactivity is not generally favored).

The threshold question under the *Bowen* analysis is whether the Lease Finance Law specifically authorizes the promulgation of retroactive rules. Neither the express language nor legislative history of the Lease Finance Law contains any specific authorization for retroactive rule making. Consequently, any rules promulgated in connection with the Lease Finance Law should have prospective effect only.

FUTURE COMMENT

Any proposed regulations affecting §67.20 and including grandfathering provisions and/or an auditor should be republished through a supplemental notice of proposed rulemaking for further comment before being made final or effective. Coast Guard and MARAD will receive and consider a great number of comments on the Joint Notice, and those comments intended by Coast Guard and/or MARAD to

be reflected in any final rule should be reviewed by the industry as a whole. Proposed regulations on these issues go to the heart of structuring transactions and consequently have great impact. Because of the intricate nature of the issues being dealt with, regulations can have unintended and/or counter-productive consequences if not subject to public scrutiny and comment. The entire industry is entitled to see detailed proposed standards and to comment on them before the matters covered in this Joint Notice and any supplemental notice became final.

SUMMARY

In summary the proposed rulemaking will serve to discourage non-coastwise citizen financing of U.S. coastwise vessels, which is contrary to the clear intent of Congress. It will not enhance security but rather will put another series of roadblocks in the path of economic rationality. None of the proposals should be adopted.

Respectfully submitted,

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